Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-5

CHARLES E. MARSH and DETROIT BANK AND TRUST COMPANY, as Co-Trustees under the Trust of ALBERT and MINNIE MARSH,
Petitioners,
v.
ARMADA CORPORATION, JERRY D. LUPTAK, HERBERT S. EPSTEIN, LEONARD FRIEDMAN, WILBUR L. ROSS, JR., GEORGE S. PIERSON, ARTHUR E. CHAMBERS, JOHN E. PUVOGEL, ROBERT I. CRATCH and THOMAS S. TALMAN,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION

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TABLE OF CONTENTS

	Page
Table of Cases Cited	i
Question Presented	1
Statement	2
Argument:	
I. The Decision Below Is Consistent With The Legislative Policy of Section 10(b) and Rule 10b-5.	2
II. The Decision Below Does Not Conflict With Decisions of Another Circuit.	6
III. The Court Below Correctly Applied Section 10(b) And Rule 10b-5.	11
Conclusion	15

TABLE OF CASES CITED

Cases:

Affiliated Ute Citizens v. U.S., 406 U.S. 128 (1972)	3
Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir. 1952), cert. denied, 343 U.S. 956 (1952)	4
Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975)	4
Ernst & Ernst v. Hochfelder, ___ U.S. ___, 96 S.Ct. 1375 (1976)	4,5,14
Green v. Santa Fe Industries, 533 F.2d 1283 (2d Cir. 1976), petition for cert. filed, 44 U.S. L. Week 3720 (U.S., June 2, 1976) (No. 75-1753)	6,9,10

Page

Marshel v. AFW Fabric Corp., 533 F.2d 1277 (2d Cir. 1976), petition for cert. filed, 44 U.S. L. Week 3720 (U.S., June 8, 1976) (No. 75-1782) 6,9,10

Mutual Shares Corporation v. Genesco, Inc., 384 F.2d 540 (2d Cir. 1967) 12

Popkin v. Bishop, 464 F.2d 714 (2d Cir. 1972) 5,7-9,11,13

SEC v. Capital Gains Research Bureau, 375 U.S. 180 (1963) 3

Vine v. Beneficial Finance Company, 374 F.2d 627 (2d. Cir. 1967), cert. denied 389 U.S. 970 (1967) 12

Statutes and Rules:

Securities Exchange Act of 1934, Section 10(b) (15 U.S.C. §78j(b)) 2-4,8,11,12

Securities Exchange Act of 1934, Rule 10b-5 (17 C.F.R. 240.10b-5) 2,4,5,8,11,12,14

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QUESTION PRESENTED

DOES A COMPLAINT, WHICH DESCRIBES A SUCCESSFUL TENDER OFFER BY THE RESPONDENT CORPORATION ACCOMPANIED BY FULL DISCLOSURE AND A SUBSEQUENT MERGER, NOT CHALLENGED HEREIN AND ADMITTEDLY FOR A VALID BUSINESS PURPOSE, ON TERMS WHICH ARE ALLEGEDLY "GROSSLY UNFAIR", STATE A CLAIM FOR RELIEF UNDER SECTION 10(b) OF THE SECURITIES EXCHANGE ACT OF 1934?

STATEMENT

The facts of the case are adequately stated in the decisions of the District Court (Petitioners' Appendix A) and the Court of Appeals (Petitioners' Appendix B).

ARGUMENT

POINT I

The decision below is consistent with the legislative policy of Section 10(b) and Rule 10b-5.

Petitioners are asking this Court to change Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") from a disclosure and anti-fraud provision to a provision requiring the Federal courts to investigate every corporate transaction involving a securities purchase or sale alleged to be "unfair". There is no Congressional or judicial support for this request. The Court below was correct in its interpretation of the scope of Section 10(b) and its analysis of the effect of the disclosure in the tender offer and subsequent actions of Armada Corporation ("Armada") on the market for the shares of Hoskins Manufacturing Company ("Hoskins"):

> "No deception in regard to the manipulation of the market price of the stock is alleged here. Armada announced that it intended to eliminate the dividend and to merge the companies if its tender offer succeeded. This is precisely what occurred. Shareholders generally know that a company with a long history of dividend payments may face a short term drop in the market value of its stock when it announces the elimination of dividends, the drop being caused largely by the immediate desire to sell by many income-seeking investors holding that stock for its dividends.

> Confronted with this announcement during the tender offer, the shareholders knew they could tender for twenty dollars a share or risk the market effect of the elimination of dividends.
>
> On the other hand, many shareholders, having faith in the merged company, might desire to exchange their Hoskins shares for Armada shares, hoping ultimately to enjoy a large increase in the value of their shares which they could sell and be taxed at capital gain rates." (Appendix B, 19a-20a)

* * * * *

"The necessity to allege more than internal self-dealing and failure to act in the best interest of the shareholders was recognized by the Supreme Court in *Superintendent of Ins.* v. *Bankers Life & Cas. Co.*, 404 U.S. 6, 12 (1971):

> 'Congress by §10(b) did not seek to regulate transactions which constitute no more than internal corporate mismanagement. But we read §10(b) to mean that Congress meant to bar deceptive devices and contrivances . . . .'" (Appendix B. 26a)

The basic philosophical premise and operational technique underlying the federal securities laws is disclosure. This Court has held that Congress intended, ". . . to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* . . . ." *Affiliated Ute Citizens* v. *U.S.* 406 U.S. 128, 151 (1972); *SEC* v. *Capital Gains Research Bureau*, 375 U.S. 180, 186 (1963).

Recently, this Court discussed the origins, underlying philosophy, Congressional intent or lack thereof, and current policy considerations in construing Section 10(b) of the Exchange Act in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975) and *Ernst & Ernst* v. *Hochfelder*, ___ U.S. ___, 96 S.Ct. 1375 (1976). Although the holding in *Blue Chip* simply affirmed the venerable purchaser-seller standing requirement of *Birnbaum* v. *Newport Steel Corp.*, 193 F.2d 461 (2d Cir. 1952), *cert. denied*, 343 U.S. 956 (1952), this Court examined the role of the federal courts in expanding civil remedies under Rule 10b-5, ". . . a judicial oak which had grown from little more than a legislative acorn," and held that new remedies should be left to Congress to fashion rather than to the courts. In *Blue Chip* this Court stated:

> "There has been widespread recognition that litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." (739)

In *Ernst & Ernst* v. *Hochfelder, supra*, this Court held that the effect of certain acts on investors is not determinative of a violation of Section 10(b) thereby further construing the intent of Congress in enacting Section 10(b). The words of the statute are the starting point in every case involving construction of a statute. The meaning of the word "manipulative" in Section 10(b) was found by this Court to be:

> "Use of the word 'manipulative' is especially significant. It is and was virtually a term of art when used in connection with securities markets. It connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." (1384)

This Court held that Rule 10b-5 cannot be read more broadly than the statute.

> "The rulemaking power granted to an administrative agency charged with the administration of a federal statute is not the power to make law. Rather, it is 'the power to adopt regulations to carry into effect the will of Congress as expressed by the statute.' (citations omitted) Thus, despite the broad view of the Rule advanced by the Commission in this case, its scope cannot exceed the power granted the Commission by Congress under § 10(b)." (1391)

Petitioners do not challenge the tender offer by Armada (Petition, p. 3). The complaint is based "on what defendants did, not what they said, omitted to say or said in a misleading way." (Petition, p. 8). Thus, petitioners are admitting that their action is not founded on any defective disclosure by respondents.

Where there has been disclosure of all material facts, there cannot be "a device, scheme or artifice to defraud" or a "fraud or deceit" under Rule 10b-5, and where there is no such deception in connection with the securities transaction, particularly a merger, the Exchange Act does not permit the federal courts to become engaged in passing on the fairness or the wisdom of the underlying transaction. This rule was recently expressed in *Popkin* v. *Bishop*, 464 F. 2d 714 (2d Cir. 1972), and is entirely consistent with this Court's limitation of Rule 10b-5 actions to those in which the defendant has a mental state embracing intent to deceive, manipulate, or defraud. *Ernst & Ernst* v. *Hochfelder, supra*. Where full disclosure is made the intent to deceive described in *Ernst & Ernst* is absent and a valid claim for relief cannot be stated under Section 10(b). The decision of the Court below is in conformity with the decision in *Ernst & Ernst* and was therefore correct.

POINT II

The decision below does not conflict with decisions of another circuit.

The decision below is not in conflict with the decisions of the Second Circuit in *Marshel* v. *AFW Fabric Corp.*, 533 F.2d 1277 (2d Cir. 1976), petition for cert. filed, 44 U.S. L. Week 3720 (U.S., June 8, 1976) (No. 75-1782) and *Green* v. *Santa Fe Industries*, 533 F.2d 1283 (2d Cir. 1976), petition for cert. filed, 44 U.S. L. Week 3720 (U.S., June 2, 1976) (No. 75-1753), but is consistent with that Court's earlier decision in *Popkin* v. *Bishop*, *supra*, which decision was not overruled in *Green* or *Marshel*.

Both the *Marshel* and the *Green* cases involved attempts by majority shareholders to eliminate minority shareholders from any equity participation in the respective corporations by payment to them of cash for their shares, popularly called a "freeze-out". In both cases, it was either stipulated or not disputed and the Court found that *there was no valid corporate business purpose for the merger* in which the minority shareholders received cash for their shares. In the case before this Court, the petitioners, formerly shareholders of Hoskins are objecting to a merger in which they received common stock of Armada in a merger which was approved by a vote of the shareholders of both corporations. Thus, petitioners continued as equity participants in the merged corporate entity and were not subjected to a "freeze-out". Petitioners admit that the

merger of Hoskins with Armada was effected with a valid business purpose. They state:

> "Here, the Armada-Hoskins merger may have had some business purpose since, as the Court recognized, 'the merger was a true combining of two businesses'." (Petition, p.p. 12-13)

The business purposes were described in the prospectus-proxy statement issued by Armada in connection with the solicitation of the shareholders' vote to approve the merger as follows:

> "The reasons for the proposed merger of Hosmanco and Hoskins are to utilize more effectively the liquid resources of Hoskins for internal expansion and acquisitions, to reduce overhead expenses through more centralization of management, to eliminate unnecessary duplications and costs occasioned by the existence of two public listed companies, to achieve full consolidation of future earnings of the Company and Hoskins and to provide the former shareholders of Hoskins with stock which will be listed on the New York Stock Exchange."

In contrast to the petitioners' contention that a conflict between circuits exists, the decision below expressly followed the decision of the Second Circuit in *Popkin* v. *Bishop*, *supra*. The Court below stated:

> "We find that *Popkin* contains the more appropriate test to apply in this case; in comparing the facts of *Popkin*, *Green* and *Marshel* to the situation here, the similarity of *Popkin* cannot be ignored." (Appendix B, 25a)

In *Popkin* v *Bishop*, *supra*, the Court affirmed the dismissal of a complaint alleging a violation of Rule 10b-5 and seeking injunctive relief on the ground that the exchange ratio in the proposed merger agreement was unfair to the plaintiff and other minority shareholders of one of the companies to be merged. In *Popkin*, three subsidary corporations were to be merged into the parent corporation in exchange for the parent corporation stock upon the vote of the shareholders of the corporations involved. The parent corporation had sufficient voting power to cause adoption of the merger proposal. A proxy statement describing the merger terms and the affairs of the corporations had been disseminated to shareholders pursuant to the requirements of the Exchange Act.

Plaintiff, a shareholder in one of the merged corporations, sought to enjoin the merger of his corporation into the defendant parent corporation on the grounds that the merger ratio was unfair. There was no claim that defendants had deceived the plaintiff. The issue squarely presented to the Court was whether full and fair disclosure under the proxy rules was sufficient to preclude a cause of action under Section 10(b) and Rule 10b-5, even though the exchange ratio in the merger was unfair. The Court held:

> "The fairness or unfairness of the exchange ratios is a complicated issue, but we do not believe that it must be resolved here. We are willing to assume that appellant is correct and that the exchange ratios are unfair. In addition, we agree that Equity's ability to push through the merger — with or without any other shareholder's vote — cannot by itself defeat a claim for federal injunctive relief." (717, 718)

The majority opinions in both the *Marshel* and *Green* cases recognized the importance of these factors and expressly did not overrule *Popkin*. In *Green*, Judge Medina, speaking for the majority, said:

> "*Popkin* holds that the primary reason misrepresentation or lack of disclosure was required was that shareholder approval was necessary. In the context of such transactions, (i.e., those for which shareholder approval is required), if federal law insures that shareholder approval is fairly sought and fully (sic) given, the principal federal interest is at an end. 464 F. 2d at 720 (material supplied). The plain implication is that in cases such as the short-form merger, where no shareholder approval is required, there is no need for a showing of misrepresentation or lack of disclosure to make out a 10b-5 case." (1291, 1292)

and in *Marshel*, the Court distinguished *Popkin* stating:

> "*Popkin* is inapposite. There a derivative action was brought to enjoin a merger on the grounds that the exchange ratios for the conversion of the common stock of the merging corporations into the stock of the surviving corporation were "unfair" to plaintiff. 464 F. 2d at 717. The propriety of the merger itself was not challenged." (1282)

The central allegation in the case at bar, as in *Popkin*, is that the merger was effected on "grossly unfair terms". This allegation was rejected in *Popkin* and by the Court below.

The differences between *Green* and *Marshel* and the case at bar were succinctly set forth by the Court below:

> "In *Green* and *Marshel* the shareholders were attacking the merger itself as a fraud. In *Popkin* as here the shareholders do not attack the merger other than upon the fairness of its terms. In *Green* and *Marshel* the merger was a sham transaction designed to expropriate the ownership interests of the minority shareholders. In *Popkin* as here the merger was a true combining of two businesses, with the shareholders of both corporations obtaining interests in the surviving corporation. In *Green* the Court stated that a transaction without notice to the shareholders should be subject to scrutiny under Rule[4] 10b-5, and in *Marshel* the Court stated that 'fraudulent practices carried out with prior disclosure to a helpless victim' should call for a Rule 10b-5 remedy. In our case, the shareholders were not 'helpless victims' because they were told of the proposed dividend elimination at a time when they had an opportunity to sell their shares at a premium; thus the impetus to distinguish *Popkin*, present in *Green* and *Marshel*, is absent here. We therefore conclude that when the shareholders allege that the terms of a merger are not only unfair but fraudulent but do not challenge the purpose of the merger they must allege deception as required by *Popkin*." (Appendix B, 25a-26a)

Petitioners are incorrect in characterizing the Armada-Hoskins merger as a "squeeze out" claiming that the "opportunity to sell at a premium was only available to 51% of the Hoskins shareholders" (Petition, p. 13), because they overlook the fact that Hoskins shareholders could sell their shares on the American

Stock Exchange at prices equal to or greater ($20 3/8 per share) than the tender offer price ($20 per share) during the tender offer period from June 4, 1973 to June 30, 1973, and that Armada purchased all of the tendered shares, which equalled approximately 52.6% of Hoskins' outstanding shares, pursuant to the exercise of Armada's option to purchase additional shares in the tender offer.

Contrary to petitioners contention that the decision below conflicts with recent decisions of the Second Circuit, it is evident that the decision of the Court below followed the decision of the Second Circuit in *Popkin* v. *Bishop, supra*, and cannot be construed as conflicting with decisions of the Second Circuit.

POINT III

The Court below correctly applied Section 10(b) and Rule 10b-5.

It is clear that the Court below did not consider the acts, conduct and statements made by defendants to constitute fraud, either as deception or misrepresentation. While it is true that Rule 10b-5 covers acts as well as verbal and written statements, the acts covered can only amount to deception when they occur without appropriate disclosure. Nondisclosures are the acts aimed at by clauses 1 and 3 of Rule 10b-5. Petitioners miss this point entirely. An act can only be fraudulent when it misleads. If the act is accompanied by full disclosure, no one can be misled by the act. It is only when innocent parties purchase and sell securities without disclosure of the manipulation that Rule 10b-5 is violated. Concentrating on "acts" or "conduct" in a Rule 10b-5 claim is only the beginning of the inquiry. The basic question must be what was the defendants conduct and did such conduct take place without full disclosure. Only

where an act occurs without disclosure or pursuant to an affirmative misrepresentation can the "deception" required under Rule 10b-5 be found. The effect of a dividend elimination on the price of Hoskins' shares was, as the District Court pointed out below, within the knowledge of "even the most unsophisticated investor." (Appendix A, 7a, 8a)

Contrary to petitioners' claim that the decision below "will be read as an emasculation of subparts (1) and (3) of Rule 10b-5" (Petition, p. 14), the decision below is consistent with the decisions cited by petitioners and considered by the Court below, by requiring deception to state a valid claim under Section 10(b). The Court below held:

> "The legal support for the shareholders' claim is found in *Mutual Shares Corp.* v. *Genesco, Inc.*, 384 F.2d 540, 546, (2d Cir. 1967), which construed two earlier cases to hold that 'manipulation of the market price and purposeful reduction of dividends in order to buy out minority stockholders cheaply was actionable under Rule 10b-5.' The Court then found a Rule 10b-5 claim based upon purposeful reduction of dividends, stating: 'Deceitful manipulation of the market price of publicly-owned stock is precisely one of the types of injury to investors at which the Act and the Rule were aimed.' 384 F.2d at 547. The deception in *Mutual Shares* arose because there was *no disclosure* of the intent or purpose of lowering dividends." (Appendix B, 20a) (Emphasis supplied)

Unlike the circumstances and nondisclosures in *Vine* v. *Beneficial Finance Company*, 374 F.2d 627 (2d Cir. 1967), cert. denied, 389 U.S. 970 (1967) and *Mutual Shares*

Corporation v. *Genesco, Inc., supra*, in the case at bar, the very acts that are claimed to be a violation of Rule 10b-5 as being a scheme to effectuate a merger on unfair terms, including, the intention to merge Hoskins and Armada and to reduce or eliminate dividends on Hoskins stock in order to utilize the liquid resources for expansion and acquisitions, were explicitly and precisely disclosed in the tender offer as required by the tender offer provisions of the Exchange Act [(15 USC §§78m(d) and 78n(d and e)], at a time when Armada did not own any shares of Hoskins common stock. Although the number of shareholders of Hoskins who tendered their shares based on the prospect of elimination of dividends cannot be precisely shown, it must be assumed that many shares were tendered in full reliance on this stated intention. Furthermore, that statement and the other representations made in the tender offer were relied on by purchasers and sellers of shares of Armada and Hoskins stock and other persons interested in these corporations.

Petitioners' claim in conclusionary language in paragraph 23(b) of the complaint that the "defendants falsely represented that any merger between Armada and Hoskins would be fair, when in fact, Armada intended from the time of the tender to merge Hoskins into Armada on grossly unfair terms for the Hoskins' shareholders." However, even if the merger ratio was "unfair" or "grossly unfair", in the absence of deception, there is no valid claim alleged. Because the fairness or unfairness of the merger ratio is not subject to judicial scrutiny, any characterization of a merger ratio as fair or unfair must perforce be excluded from court review. *Popkin* v. *Bishop, supra*.

This Court decided that the scope of the subsections of Rule 10b-5 should not be extended in *Ernst & Ernst* v. *Hochfelder, supra*, and stated:

> "Thus, despite the broad view of the Rule advanced by the Commission in this case, its scope cannot exceed the power granted the Commission by Congress under §10(b) . . . . When a statute speaks so specifically in terms of manipulation and deception, and of implementing devices and contrivances — the commonly understood terminology of intentional wrongdoing — and when its history reflects no more expansive intent, we are quite unwilling to extend the scope of the statute to negligent conduct." (1391)

There is an available forum for the petitioners' attempt to assert a claim of breach of fiduciary duty in the Michigan state court where petitioners recently filed a lawsuit* based on the same underlying facts under consideration here and where the state law questions involving alleged breaches of fiduciary duty are currently being litigated.

Charles E. Marsh, et al v. *Armada Corporation, et al*, State of Michigan in the Circuit Court for the County of Wayne, C.A. No. 76-614-064-CZ, complaint filed May 4, 1976.

CONCLUSION

For the reasons set forth above, the petition for certiorari should be denied.

Respectfully submitted,

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